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SUBJECT: NETHERLANDS' 2010 BUDGET: SPEND NOW, TOUGH CHOICES LATER

REF: (A) 08 THE HAGUE 981, (B) THE HAGUE 62, (C) THE HAGUE 221, (D)
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¶1. Summary: The Dutch government presented its 2010 budget to parliament on September 15. There were no surprises - the government agreed in March to maintain current spending levels in the 2010 budget in an effort to stimulate economic recovery. The government used the occasion to caution that, once recovery is underway as expected in 2011, significant cuts will be necessary to rein in a spiraling budget deficit. End summary.

FOCUS ON TOUGH TIMES AHEAD

¶2. In a day of tradition and high ceremony, Finance Minister Wouter Bos officially presented the 2010 budget to parliament on September 15, also known as "Prinsjesdag," and Queen Beatrix addressed the nation on the fragile state of the Dutch economy. Several days of debate now follow in which parliamentarians question ministers on a wide range of spending and policy issues. This year's budget presentation and debate differ from normal years in that the focus is not on the 2010 budget, but rather on the difficult spending cuts required in the coming few years to reverse a spiraling deficit. The coalition government, led by Prime Minister Jan Peter Balkenende, agreed in March to maintain stimulus spending and make no cuts to the 2010 budget in an effort to extricate the Netherlands from the recession it entered in the first quarter of 2009. However, the coalition warned this week that, "as soon as the economy regains sufficient strength and economic growth rises above 0.5 percent" (expected in 2011), spending cuts of up to 20 percent of the budget will need to begin in 2011 to "restore the health of public finances." Queen Beatrix echoed this message in an unusually short speech to parliament in which she urged the country to prepare for tough times ahead.

HIGHLIGHTS OF THE 2010 BUDGET

¶3. Following are highlights of the 2010 budget:

- The 2010 budget of 272.1 billion euro (USD 400 billion) represents a 23 percent increase over the 2009 budget of 221.9 billion euro (USD 326 billion).
- The government expects revenue of 239.8 billion euro (USD 352.6) in 2010, up just slightly from 2009. Coupled with the deficits expected in local government budgets, the overall public sector deficit is expected to total 36.5 billion euro (USD 53.7) or 6.3 percent of GDP in 2010.

- Government debt will increase to 381 billion euro (USD 560 billion) or 65.8 percent of GDP in 2010, compared to 59.9 percent of GDP this year.

- The major contributing factors to the rising deficit are decreased tax revenue, increased stimulus spending, bank bailouts, interest payments on increased national debt, and lower profits from natural gas.

14. The government's 2010 Budget Memorandum asserts that "an end to the economic freefall is now in sight." The projected 4.75 percent decline in GDP in 2009 is expected to be followed by zero growth in 2010. The government's priority in 2010 is to maintain stimulus spending to promote this recovery. The government announced three stimulus packages in November 2008, January 2009, and March 2009. The first package was worth 6 billion euro; the second consisted mainly of government guarantees to stimulate lending and exports; and the third package was worth 6.5 billion euro. (See refs A, B, and C.) The coalition has earmarked 4.2 billion in the 2010 budget to maintain these stimulus measures. This includes:

- 1.2 billion euro for infrastructure and construction projects, including youth care institutions, housing, schools, and restoration of historic buildings

- 905 million euro for labor market measures, including targeted action to reduce youth unemployment, additional funding for education and work placement, and part-time unemployment benefit payments

- 478 million euro to strengthen "economic sustainability," including speeding up environmental protection projects, sustainable farming, a trade-in program for old cars, additional funding for the

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energy investment tax credit, and tax incentives for entrepreneurs wishing to invest in environmentally friendly assets

- 1 billion euro in municipal and provincial stimulus measures

HIGHLIGHTS OF MINISTRY BUDGETS

15. Ministry of Defense: The defense budget will decrease slightly from 8.472 billion euro in 2009 to 8.461 billion euro in 2010. The ministry is required to find ways in 2010 to offset a number of internal setbacks, including reduced revenue from the sale of surplus material. Importantly, the ministry also must find ways to cut 65 million euro by 2011 as part of the government's overall austerity program. To realize these savings, some infrastructure projects will be delayed and support services will be cut, including scaling down the operations of the Command Service Center and Defense Material Organization to save about 100 million euro (USD 147 million). The ministry also will postpone spending on its Vehicle Replacement Program and scale down its Mortar Detection Radar and Apache Helicopter Self Protection projects. Importantly, most of the ministry's operational activities will remain untouched. The only exceptions are two Fokker 50 aircraft to be phased out in 2010, the scaling down of the Operational Support Brigade, and a reduction of 5 million euro annually in the budget for military exercises.

16. Ministry of Development Cooperation: Despite a spiralling deficit, the government is maintaining its standing commitment to donate 0.8 percent of GDP to foreign development assistance. However, as GDP continues to decline, the ministry will lose about 600 million euro, resulting in a 2010 budget of 4.7 billion euro. The cutbacks include 140 million euro less for bilateral aid to partner countries; of that, middle-income countries will receive 25 percent less and low-income countries will receive 12 percent less. Minister for Development Cooperation Bert Koenders stressed that aid

to fragile states will not be cut. The bilateral assistance budget for Afghanistan will shrink from actual expenditures of 57.8 million euro in 2008 to an expected 22 million euro in 2010. According to Peter Schuurman, Development Assistance Budget Coordinator at the Ministry of Foreign Affairs (which houses the Ministry of Development Cooperation), the smaller budget does not reflect any policy change in bilateral aid to Afghanistan. Instead, he said the Dutch Embassy in Kabul (through which the bilateral funds are channelled) has reported that it would have difficulty spending more than 22 million euro in 2010 because of the poor "safety situation in the country."

17. Meanwhile, the Dutch contributions to the UN and international financial institutions will decrease by 80 million euro in 2010, and the budget for Dutch NGOs operating in developing countries will decrease by 31 million euro. Koenders noted, however, that his ministry will continue cooperation with other ministries involved in development projects. For example, the Ministry of Justice will receive an additional 141 million euro in 2010 to shelter asylum seekers during their first year in the Netherlands.

18. Following are highlights from other ministries' 2010 budgets:

- The Ministry of Transport and Water Management will increase its budget from 8.8 billion euro in 2009 to 9.7 billion euro in 2010. Qbudget from 8.8 billion euro in 2009 to 9.7 billion euro in 2010. This is due to coalition plans to invest in several major infrastructure projects as part of its stimulus plan, including construction of bridges, railways, and highways.

- The Ministry of Justice's budget will increase from 5.7 billion euro in 2009 to 6.0 billion in 2010, largely because of an extra 214 million euro needed to support the 17,000 asylum seekers that the Netherlands expects to receive next year.

- The Ministry of Finance will significantly increase its budget from 4.2 billion euro in 2009 to 7.3 billion euro in 2010. Most of this increase is related to the government bailout of Dutch banking and insurance giant ING, in particular the ministry's decision in January to guarantee 80 percent of ING's 27.7 billion euro portfolio of U.S. medium-quality mortgage-backed securities (ref D).

- The Ministry of Economic Affairs' budget will grow from 2.8 billion euro in 2009 to 3 billion euro in 2010. This is due in large part to new loan guarantees and micro-credits for small- and medium-size companies.

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- The Ministry of Agriculture's annual budget will remain unchanged at 2.5 billion euro. This includes 900 million euro for R&D and 386 million euro for sustainable food production.

- The Ministry of Foreign Affairs will increase its budget from 9.9 billion euro in 2009 to 11.9 billion euro in 2010. The majority of these funds will continue to be devoted to the Netherlands' required financial contributions to the wide range of EU activities.

NEXT STEPS

19. Alongside the presentation of the 2010 budget, the government also set out a timeline for winding down stimulus spending and deciding upon the budget cuts necessary to counteract the rising deficit. The coalition noted that even if the economy recovers and GDP returns to its average 2 percent annual growth before the crisis, the budget deficit will barely improve and the national debt will continue to mount. The predicted deficit of 4.75 percent of GDP in 2009 is forecast to become 6.3 percent of GDP by 2010. National debt is expected to rise to 65.7 percent of GDP in 2010, with nearly 50 billion euro of that related to government intervention in the financial sector. Despite its planned outlays of 1.6 billion euro in 2009 and 4.6 billion euro in 2010 for

unemployment benefits, the government acknowledges that the labor market will likely recover more slowly than the rest of the economy. The unemployment rate is expected to rise from 5 percent in 2009 to 8 percent in 2010, leaving about 600,000 people jobless.

¶10. In keeping with its plan to maintain stimulus spending in 2010 and begin to rein in the deficit in 2011, the coalition has called for a series of "broad-based reviews" of the budget from October 2009 to May 2010. During this period, the government will ask 20 expert groups (comprised mainly of civil servants) to make recommendations on how to cut the 2010 budget by 20 percent beginning in 2011. The government will then consider these recommendations when preparing the Spring Budget Memorandum, a standard mid-year review of the budget in preparation for the release of the next year's budget in September.

COMMENT

¶11. Comment: Reaction to the 2010 budget and the government's calls for significant cuts beginning in 2011 has been wide-ranging. At one end of the spectrum, opposition parties accuse the coalition of failing to govern and simply pushing tough decisions to the next government that will take office after the 2011 elections. At the other end, the coalition argues that a reversal of stimulus spending now would spell disaster for the Netherlands' fragile recovery expected to begin in 2010 as GDP stabilizes and exports increase. While the Dutch public largely agrees that now is not the time for drastic spending cuts, they also view the current government as weak and willing to pass along difficult decisions to its successor. For now, the coalition has united in the face of criticism from opposition parties, labor unions (who criticize what they see as the government's lack of focus on rising unemployment), and other corners. The debate over the government's economic strategy will likely continue unabated in the run-up to the 2011 elections. The coalition's proposals for new austerity measures in the Spring 2010 budget review will play a major role in the upcoming election Qbudget review will play a major role in the upcoming election campaigns and the subsequent formation of a new government in 2011. End comment.

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